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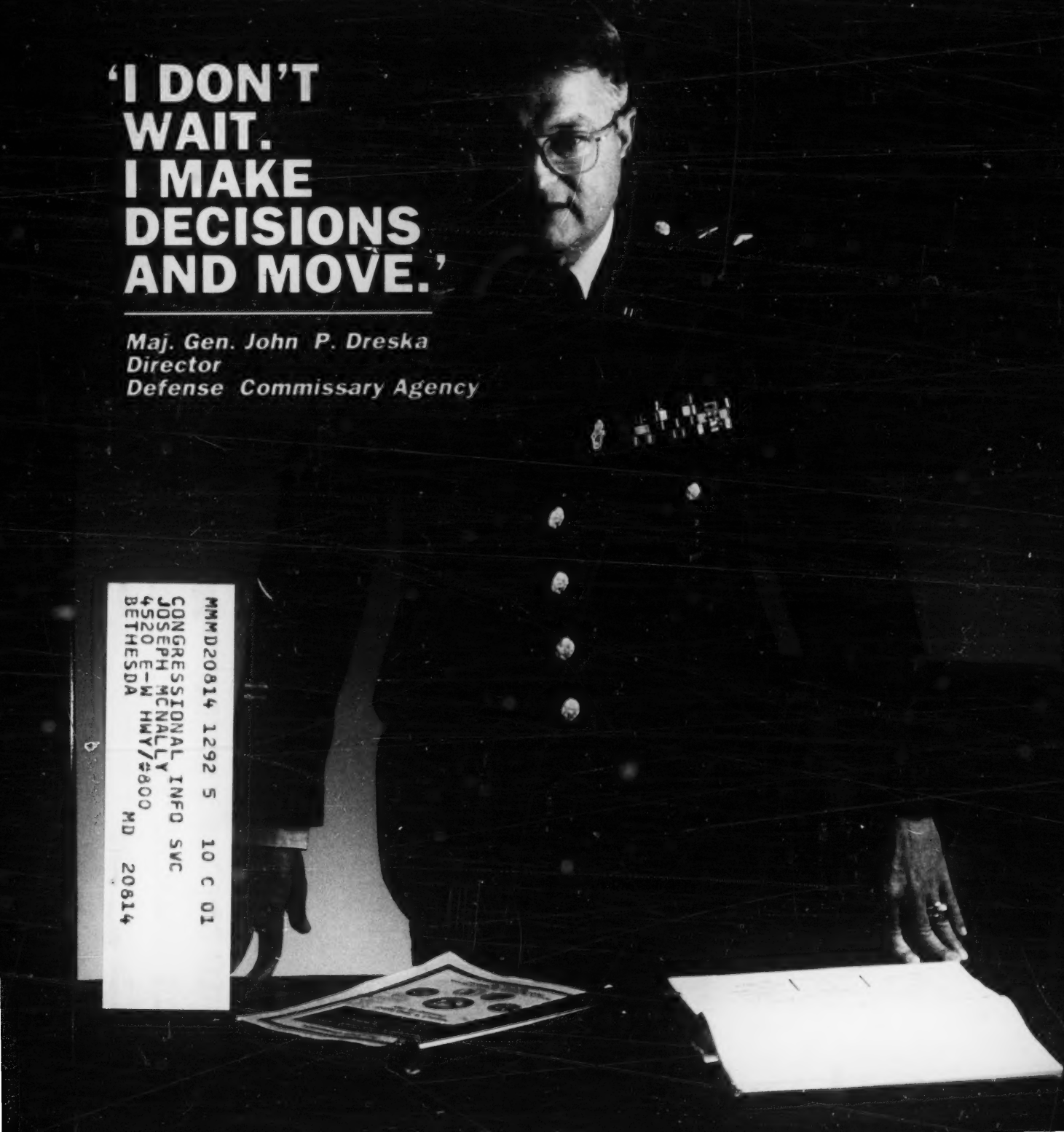
Military Market

MAGAZINE FOR THE MILITARY RESALE SYSTEM | ARMY TIMES PUBLISHING COMPANY | OCTOBER 1990 $6.00

'I DON'T WAIT. I MAKE DECISIONS AND MOVE.'

Maj. Gen. John P. Dreska
Director
Defense Commissary Agency



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Military Market Index

COMMISSARIES		JUNE			YEAR-TO-DATE		
		CY '89	CY '90	% CHANGE	CY '89	CY '90	% CHANGE
	CONUS	$127,995	$137,130	+7.1	$719,675	$774,585	+7.63
	OVERSEAS	44,940	47,775	+6.31	263,340	276,990	+5.18
ARMY	**TOTAL**	**172,935**	**184,905**	**+6.92**	**983,015**	**1,051,575**	**+6.97**
	CONUS	188,919	200,053	+5.89	1,046,714	1,146,991	+9.58
	OVERSEAS	40,749	43,275	+6.20	227,383	245,773	+8.09
AIR FORCE	**TOTAL**	**229,668**	**243,328**	**+5.95**	**1,274,097**	**1,392,764**	**+9.31**
	CONUS	79,740	83,360	+4.54	412,503	440,528	+6.79
	OVERSEAS	8,742	9,401	+7.54	45,719	47,932	+4.84
NAVY	**TOTAL**	**88,482**	**92,761**	**+4.84**	**458,222**	**488,460**	**+6.60**
	CONUS	15,347	15,745	+2.59	86,968	93,804	+7.86
	OVERSEAS	332	307	-7.53	1,941	1,730	-10.87
MARINES CORPS	**TOTAL**	**15,679**	**16,052**	**+2.38**	**88,909**	**95,534**	**+7.45**
	CONUS	324	347	+7.10	1,718	1,798	+4.66
	OVERSEAS	339	234	-21.74	1,966	1,651	-16.02
COAST GUARD	**TOTAL**	**623**	**581**	**-6.74**	**3,684**	**3,449**	**-6.38**
	CONUS	$412,325	$436,635	+5.90	$2,267,578	$2,457,706	+8.38
	OVERSEAS	$95,062	$100,992	+6.24	$540,349	$574,076	+6.24
ALL COMMISSARIES	**TOTAL**	**$507,387**	**$537,627**	**+5.96**	**2,807,927**	**$3,031,782**	**+7.97**
GROCERY STORES	*U.S.*[1]	*$28.236 bil.*	*$29.319 bil.*	*+3.84%*	*$160.074 bil.*	*$168.289 bil.*	*+5.13%*

EXCHANGES		JUNE			YEAR-TO-DATE		
	CONUS	$331,741	$345,194	+4.06	$1,764,2952	$1,933,210	+9.57
	OVERSEAS	240,880	261,045	+8.37	1,349,613	1,453,967	+7.37
AAFES	**TOTAL**	**572,621**	**606,239**	**+5.87**	**3,113,908**	**3,387,177**	**+8.78**
	CONUS[2]	891	1,119	+25.59	5,020	6,670	+32.87
	OVERSEAS[2]	1,698	2,585	+52.24	9,052	13,999	+54.65
MAIL ORDER	**TOTAL[2]**	**2,589**	**3,704**	**+43.07**	**14,072**	**20,669**	**+46.88**
	CONUS[4]	124,559	127,565	+2.41	619,850	649,789	+4.83
	OVERSEAS[4]	51,108	58,798	+15.05	259,663	291,054	+12.09
NAVY	**TOTAL[4]**	**175,667**	**186,363**	**+6.09**	**879,513**	**940,843**	**+6.97**
	CONUS	26,588	33,475	+25.90	155,166	183,669	+18.37
	OVERSEAS*	4,796	4,129	-13.91	25,350	21,542	-15.02
MARINES CORPS	**TOTAL[2]**	**31,384**	**37,604**	**+19.82**	**180,516**	**205,211**	**+13.68**
	CONUS[2]	7,226	7,954	+10.07	41,646	44,383	+6.57
	OVERSEAS[2]	618	662	+7.12	3,606	3,771	+4.58
COAST GUARD	**TOTAL[2]**	**7,844**	**8,616**	**-9.84**	**45,252**	**48,154**	**+6.41**
	CONUS	$491,005	$515,005	+4.95	$2,585,977	$2,817,721	+8.96
	OVERSEAS	$299,100	$327,219	+9.40	$1,647,284	$1,784,333	+8.32
ALL EXCHANGES	**TOTAL**	**$790,105**	**$842,526**	**+6.63**	**$4,233,261**	**$4,602,054**	**+8.71**
DEPARTMENT STORES	*U.S.*[1]	*$12.896 bil.*	*$13.458 bil.*	*+4.36%*	*$69.070 bil.*	*$73.382 bil.*	*+6.24%*

1) Source: U.S. Department of Commerce. 2) MM estimate, based on official data. 3) Includes consolidated sales for all services, including Coast Guard. 4) Does not include sales of ships stores. *Figures for Camp Butler and Iwakuni Japan, unavailable at press time, are not included. NOTE: Individual figures may not add to totals because of rounding. All sales are expressed in thousands (000), except grocery stores and department stores, which are in billions. Commissary sales include appropriate surcharges; exchange sales include concession volume. Distribution of sales by ConUS and overses is based on definition by respective service and system. Figures do not include sales tax.

Marty Baumann

JONES II

Navy's Howard "disappointed" with Rice's premise

By MICHELLE ZELSMAN

Responding to a June 4 memo by Air Force Secretary Donald Rice which called for a halt to the Armed Forces Exchange Study, Under Secretary of the Navy J. Daniel Howard said that the study should go on without bias or interference.

Howard said in a July 3 memo to Deputy Secretary of Defense Donald J. Atwood that he was "disappointed to learn that Secretary Rice had already concluded what this study group was to assess" — the feasibility of consolidation.

Howard said he strongly disagreed with "the premise that AAFES is a preferred system and with the conclusion that the consolidation should proceed."

He said that "by no means" is AAFES the most favorable operator of exchanges. The Navy and Marine Corps "would suffer significantly in performance, profitability and morale, welfare and recreation (MWR) dividends in a consolidated system," according to Howard's memo.

The memo outlines the differences in the services' fundamental operating philosophies. While AAFES has invested heavily in its overhead and infrastructures, the Navy and Marines return a "greater portion of earnings to sailors and marines in the form of MWR benefits." *[See chart.]*

Howard added that he is concerned with the basic operating principles of consolidation. Referring to available industry projections, he said that "retailers of the next decade will be highly decentralized," and not "burdened by large investments in warehouses and distribution systems."

Current Marine Corps and Navy operations will be properly positioned, he said, if this projection is correct.

He also pointed out that the Marines only recently consolidated their MWR activities into a single organization, and that the new structure provides opportunities for efficiencies and savings. Also, the Navy is moving along with its own organizational improvements.

Howard said that these matters should be addressed in the study. *[See the executive summary of the consolidation report, beginning on page 78, to see how these issues were addressed.]*

While Howard said that a consolidation study that examines the pros and cons of a possible merger is a "worthy goal," he said he is "strongly against" the presumption of an all-or-nothing option.

Howard concluded that the study should be permitted to proceed without bias or interference, and that, upon its conclusion, military service principals should be given "adequate opportunity to present arguments" relative to the recommendation.

Three Exchange Systems, 1985 - 1988

	FY '88	FY '87	FY '86	FY '85
	Net Profit as Percent of Sales			
AAFES	3.5%	4.4%	4.4%	3.6%
Marines	4.8	4.6	4.3	4.4
Navy	5.0	4.8	5.1	4.7
	MWR Dividends as Percent of Sales			
AAFES	2.0%	2.2%	2.2%	1.8%
Marines	3.6	3.7	3.7	3.7
Navy	5.0	4.1	3.5	3.6
	MWR Dividends Per Capita			
AAFES	$ 89	$ 86	$75	$57
Marines	103	106	99	96
Navy	147	115	90	97
	Percent of Return on Assets			
AAFES	8.6%	11.6%	10.7%	9.1%
Marines	14.2	15.2	11.6	12.4
Navy	14.5	13.6	15.0	15.4
	Percent of Return on Net Worth			
AAFES	12.7%	16.3%	16.2%	13.0%
Marines	20.9	24.0	15.0	17.4
Navy	24.1	22.0	23.2	23.6
	Payroll as a Percent of Sales			
AAFES	16.4%	15.2%	16.3%	15.4%
Marines	16.3	14.8	14.9	15.2
Navy	13.4	14.1	13.7	13.3
	Inventory Turns Per Year			
AAFES	2.9	3.1	3.2	3.1
Marines	4.2	3.7	3.5	3.8
Navy	3.1	3.5	3.6	3.8

SOURCE: Department of the Navy

MARINE EXCHANGES

House looks to close NAF fund loss

By MICHELLE ZELSMAN

The House Armed Services Committee is anxious to put to rest a three-year-old matter that resulted in the loss of nearly $19 million in nonappropriated funds from the Marine Corps Exchange System, said Rep. Marvin Leath, D-Texas, in a July 10 letter to the Secretary of the Navy, Lawrence Garrett, III.

Before Leath sent his letter, HASC had agreed to withhold action pending investigations being conducted by the Department of the Navy and the Department of Justice. The investigations sought to recover funds that were lost during "improper investment practices."

However the final results of these investigations were limited. Leath said, therefore, that on behalf of the integrity of the nonappropriated fund investment program, "those govern-

See NAF FUND, page 74

Military Market
MAGAZINE

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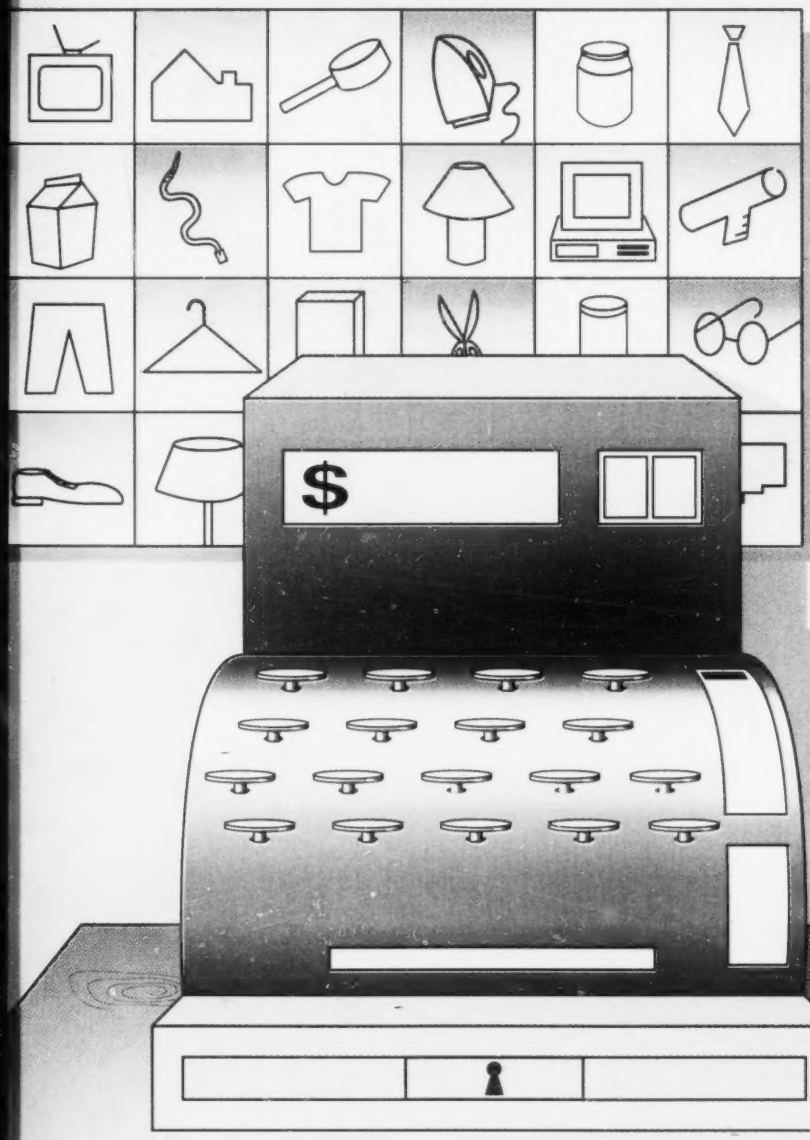

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DESIGN BY JEROLD COUNCIL

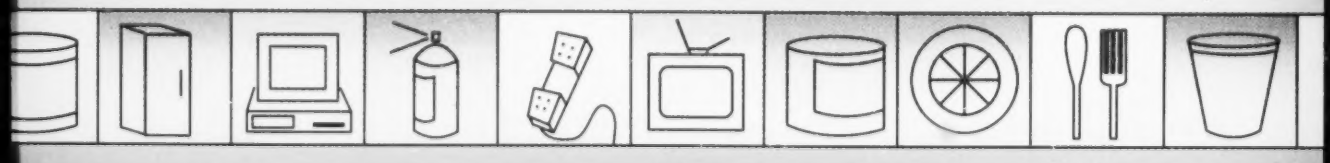
TOTAL POPULATION OF THE MILITARY COMMUNITY*

ACTIVE DUTY	NUMBER	PERCENT
Active duty personnel	2,166,146	17.4
Males	1,930,771	15.5
Females	235,375	1.9
Dependents	2,832,691	22.8
Spouses	1,187,226	9.6
Children	1,630,992	13.1
Other	14,473	0.1
Total Active Duty	**4,998,837**	**40.2**
RETIREES		
Retired military**	1,595,776	12.8
Spouses	1,250,799	10.1
Children	1,721,500	13.9
Total Retired	**4,568,075**	**36.8**
RESERVISTS		
In paid status	1,182,572	9.5
Males	1,035,050	8.3
Females	147,522	1.2
Spouses	761,576	6.2
Children	911,880	7.3
Total Reservists	**2,856,028**	**23.0**
TOTAL MILITARY COMMUNITY	**12,422,940**	**100.0**

*As of FY 1990. Includes both DoD and U.S. Coast Guard in active duty, retired and reserve personnel data.

**Includes 144,847 families receiving retired benefits under RSFPP or Survivor Benefit Plan.

SOURCE: DoD Directorate for Information, Operations and Reports.



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RACE BREAKDOWN OF ACTIVE DUTY MILITARY

CAUCASIAN
1,535,798
71%

BLACK
441,894
21%

HISPANIC
95,310
4%

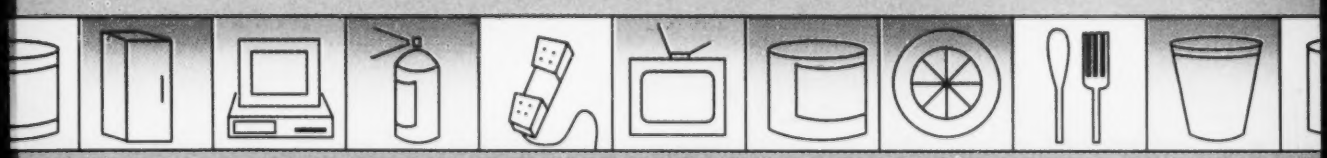
OTHER
93,144
4%

As of March 31, 1990.
SOURCE: Research Department, Army Times Publishing Co.

AGE BREAKDOWN OF ACTIVE DUTY MILITARY

Years of age	Men	Women	All
Under 21	17.39%	17.39%	17.39%
21–25	30.96%	33.91%	31.27%
26–29	17.80%	20.87%	18.14%
30–34	15.11%	16.08%	15.21%
35–39	10.96%	8.25%	10.68%
40 and over	7.79%	3.37%	7.32%

As of Fiscal Year 1990. Does not include Coast Guard.
SOURCE: DoD Directorate of Information, Operations & Reports.



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AGE DISTRIBUTION OF WIVES OF ACTIVE DUTY MILITARY

Years of age	Number	Percent
Under 20	72,540	6.1
20–24	368,634	31.0
25–29	319,235	26.9
30–34	250,030	21.1
35–39	158,741	13.4
40 and over	18,046	1.5
Total	1,187,226	100.0

As of June 30,1990.
SOURCE: Defense Eligibility Enrollment System

ACTIVE DUTY MILITARY PERSONNEL BY SEX

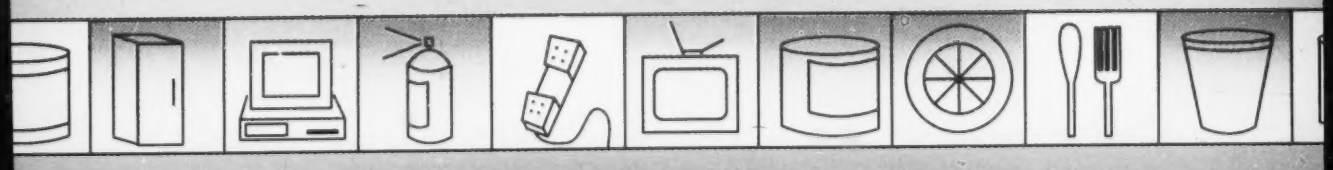
	Total Active Duty	Percent Male	Percent Female
CY1989	2,166,146	89.1	10.9
CY1988	2,174,717	89.5	10.5
CY1987	2,211,871	89.8	10.2
CY1986	2,205,497	89.8	10.2
CY1985	2,190,016	90.2	9.8
CY1984	2,176,628	90.6	9.4
CY1983	2,123,349	90.7	9.3
CY1982	2,108,612	91.0	9.0

As of September 30th for each year listed.
SOURCES: DoD and Department of Transportation.

AGE DISTRIBUTION OF DEPENDENT CHILDREN OF ACTIVE DUTY MILITARY

Years of age	Number	Percent
Under 5	497,371	30.5
5–9	567,748	34.8
10–14	394,700	24.2
15–17	171,173	10.5
Total	1,630,992	100.0

As of June 30, 1990.
SOURCE: Defense Eligibility Enrollment System



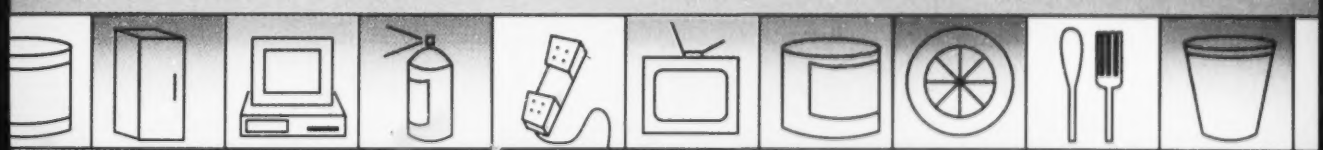
The Market

ACTIVE DUTY MILITARY BY RANK, SEX AND SERVICE

Rank	ARMY Male	ARMY Female	NAVY Male	NAVY Female	MARINE CORPS Male	MARINE CORPS Female	AIR FORCE Male	AIR FORCE Female
OFFICERS								
O-7–O-10	398	2	254	2	69	1	331	2
O-6	4,123	119	3,746	113	629	10	5,182	122
O-5	9,967	630	7,239	512	1,585	25	11,628	587
O-4	15,323	1,732	12,073	1,588	3,129	89	17,696	2,018
O-3	26,763	4,823	20,269	2,861	5,951	234	37,148	6,106
O-2	11,454	2,375	9,931	1,242	4,079	148	10,090	2,665
O-1	9,823	2,063	8,446	1,097	2,498	120	8,019	1,905
Warrant officers	14,811	453	2,742	38	1,463	69	0	0
Total officers	**94,680**	**12,197**	**64,700**	**7,453**	**19,403**	**696**	**90,294**	**13,403**
ENLISTEDS								
E-9	4,182	51	4,712	35	1,484	13	4,590	36
E-8	14,280	322	10,021	219	3,720	58	8,999	232
E-7	48,497	2,718	32,679	1,487	9,156	233	37,120	2,098
E-6	82,117	7,978	76,594	6,059	14,631	738	52.047	5,570
E-5	105,780	13,943	93,411	11,563	24,303	1,669	96,961	14,434
E-4	158,372	26,307	95,583	11,897	31,711	2,029	110,557	20,336
E-3	81,378	10,257	59,670	8,989	51,290	2,508	55,256	12,224
E-2	45,051	6,633	46,816	5,942	20,051	1,193	21,221	5,021
E-1	44,870	5,585	44,779	5,442	11,499	571	12,905	3,224
Total enlisteds	**584,527**	**73,794**	**464,265**	**51,633**	**167,845**	**9,012**	**399,656**	**63,175**
CADETS/MIDSHIPMEN	**4,040**	**503**	**4,169**	**432**	**0**	**0**	**3,827**	**525**
GRAND TOTAL	**683,247**	**86,494**	**533,134**	**59,518**	**187,248**	**9,708**	**493,777**	**77,103**

Rank	TOTAL DoD Male	TOTAL DoD Female	TOTAL DoD Total	COAST GUARD Male	COAST GUARD Female	TOTAL ALL SERVICES Male	TOTAL ALL SERVICES Female	TOTAL ALL SERVICES Total
OFFICERS								
O-7–O-10	1,050	7	1,057	27	0	1,077	9	1,084
O-6	13,680	364	14,044	351	0	14,031	364	14,395
O-5	30,339	1,754	32,393	669	3	31,308	1,757	33,065
O-4	48,221	5,425	53,646	974	18	49,195	5,443	54,638
O-3	92,131	14,024	106,155	1,649	94	93,780	14,118	107,898
O-2	35,554	6,430	41,984	865	88	36,419	6,518	42,937
O-1	28,786	5,185	33,971	488	69	29,274	5,254	34,528
Warrant officers	19,016	560	19,576	1,328	13	20,344	573	20,917
Total officers	**269,077**	**33,749**	**302,826**	**6,351**	**285**	**275,428**	**34,034**	**309,462**
ENLISTEDS								
E-9	14,968	135	15,103	282	0	15,250	135	15,385
E-8	37,020	831	37,851	554	1	37,574	832	38,406
E-7	127,452	6,536	133,988	2,669	50	130,121	6,586	136,707
E-6	225,389	20,345	245,734	5,429	286	230,818	20,631	251,449
E-5	320,455	41,609	362,064	5,450	459	325,905	42,068	367,973
E-4	396,223	60,569	456,792	5,982	718	402,205	61,287	463,492
E-3	247,594	33,978	281,572	3,759	419	251,353	34,397	285,750
E-2	133,139	18,789	151,928	2,668	309	135,807	19,098	154,905
E-1	114,053	14,822	128,875	221	25	114,274	14,847	129,121
Total enlisteds	**1,616,293**	**197,614**	**1,813,907**	**27,014**	**2,267**	**1,643,307**	**199,881**	**1,843,188**
CADETS/MIDSHIPMEN	**12 036**	**1,460**	**13,496**	**0**	**0**	**12,036**	**1,460**	**13,496**
GRAND TOTAL	**1,897,406**	**232,823**	**2,130,229**	**33,365**	**2,552**	**1,930,771**	**235,375**	**2,166,146**

DoD data as of Fiscal Year 1990. Coast Guard data as of July 24, 1990.



The Market

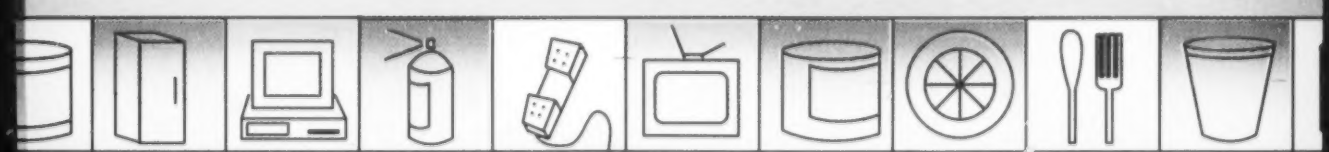
RESERVE FORCES IN PAID STATUS

ARMY RESERVE	
Officers	62,372
Enlisted	256,872
Total	**319,244**
ARMY NATIONAL GUARD	
Officers	50,112
Enlisted	406,848
Total	**456,960**
NAVAL RESERVE	
Officers	28,977
Enlisted	122,528
Total	**151,505**
MARINE CORPS RESERVE	
Officers	3,628
Enlisted	39,948
Total	**43,576**
AIR FORCE RESERVE	
Officers	17,088
Enlisted	66,126
Total	**83,214**
AIR NATIONAL GUARD	
Officers	14,081
Enlisted	101,980
Total	**116,061**
DoD RESERVES (Total)	
Officers	176,258
Enlisted	994,302
Total	**1,170,560**
COAST GUARD RESERVE*	
Officers	1,595
Enlisted	10,417
Total	**12,012**
TOTAL (All Services)	
Officers	177,853
Enlisted	1,004,719
Total	**1,182,572**

As of Fiscal Year 1990.

*The Coast Guard is part of the Department of Transportation.

SOURCE: DoD Directorate of Information, Operations and Reports

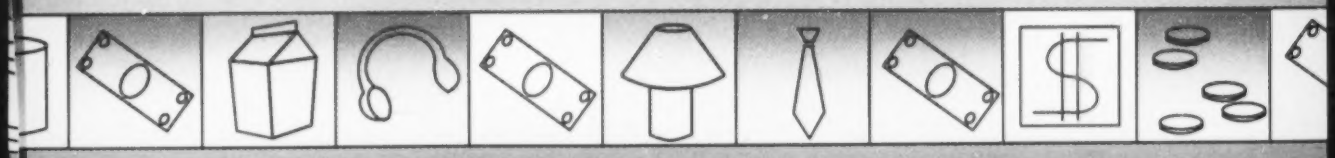


Compensation

1990 ACTIVE DUTY MILITARY ANNUAL COMPENSATION	
Average military compensation	$32,115*
Regular military compensation	25,462
Basic pay	17,600
Basic allowance for quarters	2,989
Variable housing allowance	785
Station allowance overseas	278
Subsistence allowance	2,112
Federal income tax advantage	1,698
Special pays & consumption advantage	6,653
Special allowances	594
Special and incentive pays & bonuses	1,146
Commissary and exchange savings	575
Free/reduced cost medical & dental care	2,460
Retirement credit, current year's service	696
Social Security payments (government contributions)	1,182

*Annual rate, including value of fringe benefits and consumption advantages. The breakdown above represents per-capita amounts derived by dividing the total value of each category by the number of active duty personnel.

SOURCE: Estimates based on DoD Personnel Budget for Fiscal Year 1990.



Compensation

AVERAGE MILITARY COMPENSATION FOR THE PAST 10 YEARS

FY 1990	$32,115
FY 1989	30,855
FY 1988	29,438
FY 1987	28,416
FY 1986	27,682
FY 1985	26,915
FY 1984	25,902
FY 1983	24,656
FY 1982	23,538
FY 1981	20,546

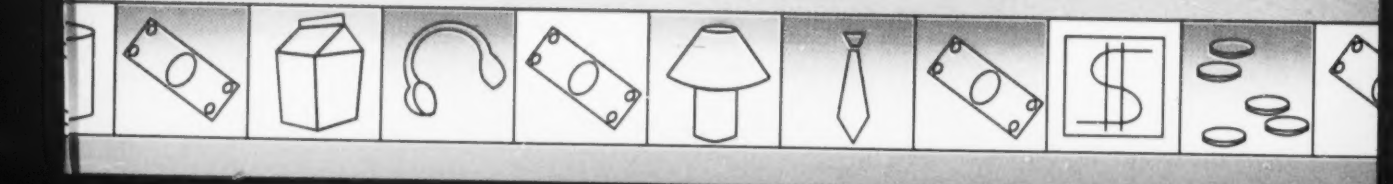
SOURCE: DoD Military Personnel Budget for the years shown.

INCOME OF THE MILITARY COMMUNITY FY 1990

Active Duty Military		Retired Military		Reservists In Paid Status	
Total	$77.1		$60.2		$39.1
Military pay, allowances, benefits	$68.4	Pensions	$21.5	Employment	$25.9
Moonlighting and working spouses income	$8.7	Second career jobs	$28.1	Working spouses income	$6.8
		Working spouses income	$10.6	Reservist training pay	$6.4
Total income of the military community					$176.4 billion

$ in billions.

SOURCES: DoD Personnel Budget for Fiscal Year 1990 and Department of Commerce and Bureau of the Census data for non-government income of families in the military community.



Market Retail Sales

LARGEST SUPERMARKET CHAINS CY 1989

1 American Stores	$ 22.0
2 Kroger	18.8
3 Safeway	14.3
4 Super Value Stores	10.3
5 A & P	10.1
6 Winn-Dixie	9.2
7 Albertson's	6.8
8 Worldwide Commissaries	**5.7**
9 Vons	5.2
10 Domestic Commissaries	**4.7**

$ in billions.

Worldwide military commissary sales remained in 8th place while domestic commissaries lost their previous 9th place ranking to Vons and dropped to 10th place. Likewise, Kroger lost its first place ranking to American Stores and replaced American in second place.

Commissary sales include the 5 percent surcharge.

SOURCES: Sales of civilian supermarket chains were obtained from Standard and Poor's Corporate Descriptions On-Line. Military commissary sales are as reported by the headquarters offices of the various commissary systems.

COMBINED SALES FOR COMMISSARIES AND EXCHANGES

CY 1989	$15.199 billion
CY 1988	$14.467 billion
CY 1987	$13.705 billion
CY 1986	$12.660 billion
CY 1985	$12.155 billion
CY 1984	$12.068 billion
CY 1983	$11.789 billion
CY 1982	$11.354 billion
CY 1981	$10.640 billion
CY 1980	$9.863 billion

THE MARKET'S RETAIL SALES

COMMISSARIES
$5,657.9 million

37.2%

EXCHANGES*
$9,541.2 million

62.8%

TOTAL
$15,199.1 million

100.0%

* Includes sales by mail order catalog, concessions, food service, personal services, etc.

LARGEST DEPARTMENT STORE AND VARIETY CHAINS CY 1989

1 Sears	$ 31.6
2 K mart	27.3
3 Wal-Mart	25.1
4 J.C. Penney	16.1
5 May Department Stores	13.0
6 Dayton-Hudson	12.2
7 Federated Department Stores	11.2
8 Worldwide Military Exchanges	**9.5**
9 F.W. Woolworth	8.1
10 Domestic Military Exchanges	**6.0**

$ in billions.

Worldwide and domestic military exchange sales in 1989 maintained their previous rankings of 8th and 10th place, respectively. In fact, the only change in 1989 was the swapping of positions by Federated Department Stores and the Dayton-Hudson chain. Dayton-Hudson replaced Federated in 6th place, while Federated dropped to 7th place.

SOURCES: Sales of civilian department store chains were obtained from the following on-line computer data bases: Standard and Poor's Corporate Descriptions and Disclosures On-Line. Military exchange sales are as reported by the headquarters offices of the various exchange systems.

Exchanges

10-YEAR EXCHANGE SALES GROWTH

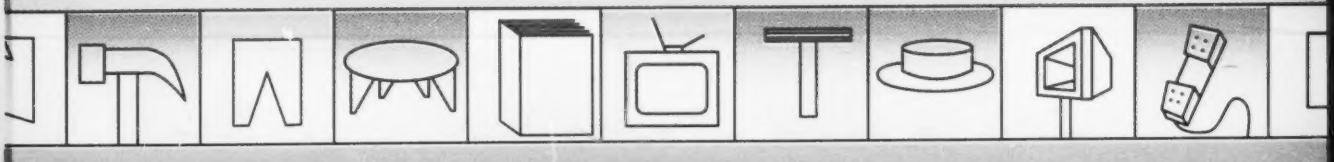
CY 1989	$9.541
CY 1988	$8.910
CY 1987	8.443
CY 1986	7.613
CY 1985	7.238
CY 1984	7.194
CY 1983	6.878
CY 1982	7.083
CY 1981	6.388
CY 1980	5.944

$ in billions.
SOURCE: Headquarters offices of exchange systems.

EXCHANGE SALES BY REGION CY 1989

System	Domestic	Percent of Total	Overseas	Percent of Sales	Worldwide	Percent of Total
AAFES	$3,900.0	65.1	$2,877.4	81.0	$6,777.4	71.0
Navy	1,334.1	22.3	552.1	15.5	1,886.2	19.8
Marine Corps	462.5	7.7	113.4	3.2	575.9	6.0
Coast Guard	112.5	1.9	9.1	0.3	121.6	1.3
VCS	180.2	3.0			180.2	1.9
TOTAL	$5,989.2	100.0	$3,552.0	100.0	$9,541.2	100.0

$ in millions



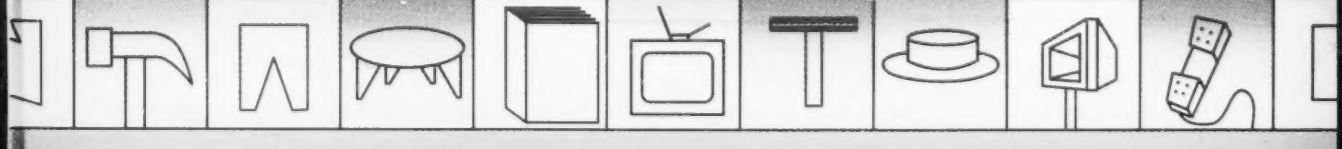
Exchanges

EXCHANGE RETAIL SALES BY DEPARTMENT AND BY AREA CY 1989

DEPARTMENT	CONUS	%	OVERSEAS	%	WORLDWIDE	%
Automotive accessories	$122,679,730	2.6	$65,950,420	2.3	$188,630,151	2.5
Gasoline/fuel[1]	372,312,068	8.0	173,775,677	6.1	546,087,745	7.3
Automotive labor[2]	23,976,008	0.5	8,073,021	0.3	32,049,029	0.4
Tobacco products, incl. vending	263,304,247	5.7	68,178,049	2.4	331,482,296	4.4
Military uniforms, incl. DPSC	259,252,243	5.6	82,698,057	2.9	341,950,300	4.6
Convenience foods, candy, snacks	256,089,265	5.5	207,491,172	7.3	463,580,437	6.2
Wine, wine coolers[3]	55,844,089	1.2	25,019,103	0.9	80,863,192	1.1
Beer and beverages[4]	212,697,730	4.6	87,087,767	3.1	299,785,497	4.0
Distilled spirits[5]	167,288,620	3.6	64,067,528	2.2	231,356,148	3.1
Carbonated beverages	52,999,316	1.1	71,462,098	2.5	124,461,414	1.7
Health & beauty aids (toiletries)	214,559,425	4.6	115,940,666	4.1	330,500,091	4.4
Cosmetics & fragrances	133,759,350	2.9	57,525,648	2.0	191,284,997	2.5
Jewelry, including precious jewelry	117,925,998	2.5	83,160,938	2.9	201,086,936	2.7
Watches	54,929,725	1.2	31,248,514	1.1	86,178,239	1.1
Stationery	70,534,634	1.5	24,643,354	0.9	95,177,988	1.3
Greeting cards	59,334,144	1.3	30,854,542	1.1	90,188,686	1.2
Books & periodicals	90,794,510	2.0	40,086,740	1.4	130,881,250	1.7
Men's outerwear	95,466,464	2.1	62,200,138	2.2	157,666,602	2.1
Men's furnishings	178,313,719	3.8	81,827,064	2.9	260,140,783	3.5
Women's outerwear	144,202,437	3.1	89,847,314	3.1	234,049,751	3.1
Women's furnishings	95,140,187	2.0	37,506,180	1.3	132,646,367	1.8
Boyswear	39,272,552	0.8	24,263,012	0.9	63,535,563	0.8
Girlswear	35,896,230	0.8	24,059,590	0.8	59,955,821	0.8
Infants & toddlers wear	51,432,658	1.1	33,034,607	1.2	84,467,265	1.1
Footware & family shoes	148,715,717	3.2	82,483,846	2.9	231,199,563	3.1
Linens & domestics	63,669,138	1.4	39,400,431	1.4	103,069,569	1.4
Yardage & sewing notions	6,543,072	0.1	14,196,480	0.5	20,739,552	0.3
Dinnerware & flatware	18,179,421	0.4	12,001,300	0.4	30,180,721	0.4
Kitchenware	45,980,294	1.0	27,036,039	0.9	73,016,333	1.0
Giftware	55,242,551	1.2	44,938,711	1.6	100,181,262	1.3
Cleaning supplies	58,198,596	1.3	32,047,381	1.1	90,245,978	1.2
Traffic & major appliances	94,832,840	2.0	71,208,438	2.5	166,041,278	2.2
Furniture & home furnishings	45,758,374	1.0	91,887,536	3.2	137,645,910	1.8
Hardware, garden, pet supplies	107,443,602	2.3	43,218,592	1.5	150,662,194	2.0
Luggage	33,750,009	0.7	13,767,284	0.5	47,517,293	0.6
Garden/patio furniture (outdoor)	106,084,935	2.3	22,734,239	0.8	128,819,174	1.7
Sporting goods	67,317,661	1.4	39,241,841	1.4	106,559,502	1.4
Photo finishing	23,558,442	0.5	7,538,453	0.3	31,096,895	0.4
Photography & optical[6]	73,259,906	1.6	52,694,420	1.8	125,954,326	1.7
Toys, games & bicycles	84,361,567	1.8	75,739,313	2.7	160,100,880	2.1
Computers & accessories[7]	64,671,679	1.4	64,024,744	2.2	128,696,422	1.7
Consumer electronics	305,134,726	6.6	407,481,021	14.3	712,615,747	9.5
Recorded sound & video	75,524,821	1.6	120,180,582	4.2	195,705,403	2.6
Video rental	1,690,685	0.0	1,951,884	0.1	3,642,569	0.0
TOTAL RETAIL[8]	**$4,647,923,386**	**100.0**	**$2,853,773,733**	**100.0**	**$7,501,697,118**	**100.0**

[1] AAFES Retail Department 2, and Navy Services Department J-3. [2] AAFES Retail Department 3, and Navy Services Department J-5. [3] AAFES Retail Department 22, and Navy Retail Department A-9. [4] AAFES Retail Department 23, and Navy Retail Department A-6. [5] AAFES Retail Department 25, and Navy Retail Department A-9. [6] AAFES Retail Department 93, and Navy Retail Department B-1, and Navy Services Dept. K-2. [7] AAFES Retail Department 96, and Navy Retail Department B-7. [8] With the exceptions indicated in footnotes, 1, 2, 3 and 5, the above totals do not include sales of food or services departments such as cafeterias, snack bars, beauty and barber shops, nor do they include concession sales. No vending sales are included, with the exceptions of tobacco and beverage vending, as noted above.

SOURCE: Research Department, Army Times Publishing Company.



Commissaries

10-YEAR COMMISSARY SALES GROWTH

CY 1989	$5.656
CY 1988	$5.557
CY 1987	5.262
CY 1986	5.047
CY 1985	4.918
CY 1984	4.874
CY 1983	4.705
CY 1982	4.476
CY 1981	4.251
CY 1980	3.919

$ in billions.

SOURCE: Headquarters offices of commissary systems.

COMMISSARY SALES BY REGION CY 1989

System	Domestic	Percent of Total	Overseas	Percent of Total	Worldwide	Percent of Total
Air Force	$2,047.0	44.3	$443.8	43.0%	$2,490.8	44.0
Army	1,570.3	33.9	425.6	41.2	1,995.9	35.3
Navy	830.2	17.9	91.6	8.9	921.8	16.3
Marine Corps	174.8	3.8	3.9	0.4	178.7	3.2
Coast Guard	3.4	0.1	3.9	0.4	7.3	0.1
State Department			63.5	6.2	63.5	1.1
TOTAL	$4,625.7	100.0	$1,032.3	100.0	$5,658.0	100.0

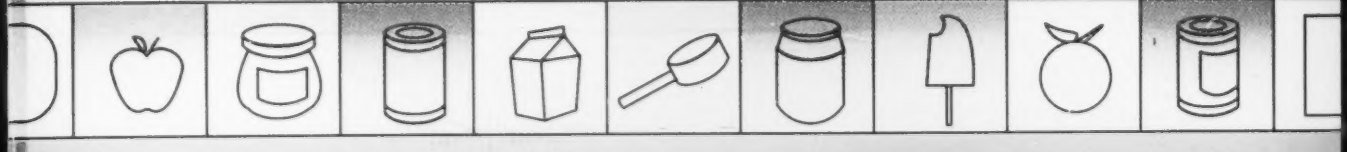
$ in millions

COMPARISON OF PERCENT SALES BY MAJOR DEPARTMENT COMMISSARIES VS. CIVILIAN SUPERMARKETS CY 1989

	Average Percent of Total Sales MEAT	Average Percent of Total Sales PRODUCE	Average Percent of Total Sales GROCERY
Army commissaries	13.7	4.7	81.6
Air Force commissaries	15.3	5.4	79.3
Navy commissaries	16.8	6.9	76.3
Marine Corps commissaries	16.1	6.1	77.8
Combined military commissaries	15.1	5.4	79.5
Civilian supermarkets	18.8	10.5	70.7

Surcharge has not been included in commissary sales. Therefore, military ratios are from cash register prices. No adjustment has been made for lower commissary price levels.

SOURCES: For commissaries, reports received from headquarters offices of the four military commissary systems shown. For supermarkets: "1990 Supermarket Sales Manual," *Progressive Grocer*, July 1990. To insure comparability, the percent of total sales by department exclude those categories of items not stocked in military commissaries, such as beer, wine, housewares, softgoods, books, periodicals and other non-food general merchandise. However, tobacco sales have been retained, even though Navy commissaries stock these items on a limited basis.



A DOD STUDY OF MILITARY EXCHANGES

This is the second and final draft version of the executive summary of DoD's exchange consolidation report. It recommends that the three Defense Department exchange systems be consolidated, but warns that on-going changes in DoD and the world situation indicate that such a consolidation be done slowly. The executive summary condenses the recommendations that appear in the report's 12 chapters; more details on specific recommendations appear in the relevant chapters. *Boldface italics have been added to highlight special topics.*

BASIS FOR SUBMISSION

This report on the Armed Services Exchange System is submitted in response to the request of the Honorable Marvin Leath (D-TX), Chairman of the Morale, Welfare and Recreation Panel, Subcommittee on Readiness, Committee on Armed Services, United States House of Representatives. The request to the Department of Defense was transmitted in a 22 January 1990 letter from Congressman Leath to Lieutenant General Donald W. Jones, Deputy Assistant Secretary of Defense (Military Manpower and Personnel Policy). Based on this request, Mr. [Donald J.] Atwood (Deputy Secretary of Defense) directed that a review of the military exchanges be conducted. This directive led to the formation of an exchange study group with representatives from each of the Armed Services, the Army and Air Force Exchange Service (AAFES), and the U.S. Coast Guard. Due to the limited time available to conduct the study, and the need for individuals sufficiently experienced and knowledgeable in exchange operations, the Services selected personnel from their exchange systems with extensive resale experience.

The study group prepared this macro, conceptional report with input from review and steering groups comprised of senior military and civilian leaders, a technical advisory group of exchange system commanders, functional experts from the exchange systems' staffs, installation commanders, the senior noncommissioned officers of the military services and exchange patrons. All cost and savings projections for the alternatives considered are based on estimates developed by the study group staff. All estimates are, however, considered conservative.

The report is organized into the following chapters:

- Chapter 1 summarizes the study report, gives the basis for submission and outlines the study group's overall assumptions, methodology, findings, conclusions, and final recommendations.
- Chapter 2 gives a history and evolution of the exchange systems, presents the current scope of operations and provides a description of each of the separate exchange systems.
- Chapter 3 analyzes current financial, business and organizational strategies of the exchange systems, explains current MWR distribution policies, and details estimated savings and one time implementation costs.
- Chapter 4 examines exchange procurement and inventory management functions and potential benefits through centralization.
- Chapter 5 reviews the existing distribution and transportation systems of the exchange systems and proposes organizational changes to increase efficiency.
- Chapter 6 examines current and projected management information systems utilized by the exchanges.
- Chapter 7 focuses on customer service, store and installation operating procedures and special exchange programs.
- Chapter 8 discusses the various food programs of each service, including the potential for increased service and earnings.
- Chapter 9 discusses the broad category of services operations and how each exchange system fulfills these requirements.
- Chapter 10 outlines options for operating design construction departments of the exchange systems more cost effectively.
- Chapter 11 discusses human resources program similarities and differences of each system and potential efficiences through cooperative actions.
- Chapter 12 examines the employee benefits programs of each system and the costs and impact of any proposed change.
- Finally, there are several appendices which provide additional data and a more detailed analysis of specific topics.

STUDY OBJECTIVE

The study mission was to provide an unconstrained baseline assessment of the Department of Defense Armed Forces exchange system with the objective of identifying increased efficiencies, reducing overhead costs and increasing savings in nonappropriated fund and appropriated fund revenues. Any recommended changes were to maintain the same or higher level of service to the customer with no increase in cost. All functional areas of the exchange systems were subject to review for efficiencies, with the review to include, but not be limited to, the feasibility of consolidating some or all functional areas.

THE EXCHANGE MISSION

Each of the exchange systems has a similar dual mission of providing patrons with merchandise and services necessary for their health, comfort and convenience, and of serving as a supplemental source of funding for military Moral, Welfare and Recreation (MWR) programs. The exchange [sic] located on military installations encompass a wide variety of resale activities, and compare favorably with commercial retail stores and shopping malls. Included in the list of exchange activities are retail, food and automotive outlets; personal services such as barber shops, beauty shops and laundry/dry cleaning; amusement and vending centers; Navy Lodges; and, in the case of AAFES, motion picture theaters. The exchanges serve as an important nonpay military benefit, providing vital services worldwide and saving the patron an average of 20% over outside prices.

The exchange systems are unique government organizations in that they operate almost entirely on revenues generated from the sale of goods and services. These sales dollars pay for civilian employee salaries, merchandise inventory investment, most distribution and utilities costs and capital expenditures for equipment, vehicles and facilities — in short, all the normal costs of doing business. Limited appropriated fund (tax dollar) support is received for paying some overseas transportation costs; utilities overseas and in designated isolated and remote areas; and common services such as fire and police protection.

Exchanges are an integral part of the military Services quality of life programs, providing on-base services as well as generating earnings to support MWR programs such as libraries, child care and youth centers, fitness programs and other vital quality of life programs.

FINDINGS

The review group soon determined that the current exchange systems are financially sound, serving their patrons well and making valuable contributions to the MWR program. However, with three separate exchange systems accomplishing the same basic mission, often within the same geographical area, there are duplications and redundancies in both overhead and operating costs. This is in no way meant to imply that any one of the systems

(Continued)

A DOD STUDY OF MILITARY EXCHANGES

is not pursuing actions to optimize their separate operation.

Yet, these are tumultuous times. So any immediate, systemwide consolidation taken simply to realize the anticipated savings identified in this study would involve significant risks and could adversely affect customer service, ongoing programs and exchange earnings, and ultimately support to MWR.

The exchange systems today are operating in a rapidly changing political environment and are absorbed in the process of adjusting to a variety of internal and external influences beyond their control. These factors are impacting on traditional methods of operation, and any attempt to project future savings on recent historical data must take them into account. In an unbelievably short span of time we've seen the Berlin Wall come down, action initiated and almost concluded for the reunification of Germany, political reforms instituted in the Soviet Union, the loosening of the Soviet grip on her member states, and an overall reduction in tensions between East and West. This has led to calls for massive cuts in defense spending which will be reflected in major force reductions and base closures. In a 19 June 1990 news briefing, Secretary of Defense [Richard D.] Cheney responded to a Congressional inquiry regarding the impact of a 25% force reduction — equal to approximately 442,000 military personnel. The most recent crisis in the Middle East may also influence future force structure and basing decisions.

The exchanges are also facing increased competition from outside retailers, which is expected to grow through niche formats, everyday low prices, warehouse/superstores and the movement of major competitors into sections of the country they did not previously operate. To remain competitive, the exchanges must stay abreast of and implement current retailing concepts such as electronic data interchange and rapid replenishment by suppliers.

Each of the separate exchange systems has responded to this changing environment by instituting actions to scale down and consolidate overhead operations and reduce costs to meet the challenge of significant reductions in the patron base. Within AAFES, project "Fresh Start" is well underway. This project will reduce and relocate the four major CONUS geographical headquarters elements to Dallas. Additionally, actions have been initiated in both Europe and the Pacific to reduce staffing to meet reduced support requirements due to changes in force levels. AAFES' automated management information and communication systems are being greatly expanded with a satellite communication network and installation level computers to support operations and decision making functions.

The Navy Resale System has begun steps to reduce costs by reducing the number of Field Support Offices (FSOs) and further centralizing some distribution and procurement functions. Additionally, the Navy Resale System is faced with the complicated process of divesting commissary operations and the associated organizational turmoil. The Navy also has a program to update and improve their management information system.

In the Marine Corps, the exchange and MWR activities were merged into a single organization barely a year ago. Any immediate exchange consolidation would require this organization to be split at a time when is both recovering from this action and is placing total concentration and effort on managing the eminent [sic] changes due to force structure adjustments.

Although the U.S. Coast Guard participated in this study, primarily in an observer status, no consideration was given nor analysis performed on including them in any consolidation of the Armed Services exchange systems.

ANALYSIS OF ALTERNATIVES

The study group considered and evaluated a number of alternatives, including continuation of separate systems (status quo), a variety of partial consolidation scenarios such as centralized support to separate systems and geographical responsibility by dominant system, operation as a government sponsored enterprise (GSE), and total consolidation. Since the partial consolidation scenarios were cumbersome, did not provide major savings and were not supported by the military Services, they are not presented here. These alternatives are, however, discussed in later chapters and could become a step in the movement to total consolidation if that course of action is selected. There appears to be no advantage in converting from a nonappropriated fund instrumentality to a GSE.

The major pros and cons of the two remaining alternatives, status quo and total consolidation, as identified by the study group, are summarized in Figure 1-1 at the end of this chapter.

CONCLUSIONS

Despite the complexity of this action, total consolidation of the three military exchanges is feasible and is the most cost effective alternative. There currently is, in fact, a consolidated exchange system in existence. AAFES serves both the Army and Air Force worldwide. ***While the study group can identify savings through further exchange consolidation, such action must be taken carefully over time due to force structure uncertanties [sic], with check points built in for review action before moving from phase to phase.***

Figure 1-2 presents a summary of projected savings and costs which could be realized through a total consolidation of the exchange systems. Net savings are expected to be $35 million annually. (The full impact of these savings would not be realized until the end of the implementation period.) One-time net implementation costs, projected to be $6.0 million, and the impact on personnel are also summarized in Figure 1-3. Chapter 3 gives a more detailed analysis and explanation of the savings and cost figures. ***It should be noted that the personnel impact of consolidation would be substantial and every effort should be made to reduce the affect [sic] on individuals, such as offering early retirement, placement services, etc.***

Since AAFES is the largest system (73% of total direct sales; 74% of employees) and has in place a worldwide, sophisticated infrastructure, it is only logical that any consolidation would be built around this infrastructure.

The basic methodology used as a starting point for determining costs and savings in each of the functional areas was as follows (using AAFES as the core organization):

- Identified common functions and eliminated the positions currently performing those functions at Navy and Marine Corps Headquarters, Regional and Local Levels.
- Based on a selected productivity measure, determined cost of adding additional people to the core organization (Total people required less those on hand at core organization).
- Net savings is the difference between total savings and added cost.
- Compute one-time implementation costs.
- Once this was determined, it was refined by comparing more closely the actual functions being performed by the personnel in each exchange system.

Conclusions relating to each of the major functional areas follow:

■ ***Financial/Business Strategy.*** Because of differences in accounting procedures, financial reporting, operating environments and other factors, comparison of financial indicators for the exchange systems is not an accurate measure of performance. However, all three systems are financially healthy, with profitability figures that generally exceed commercial industry averages. Each system provides patrons a savings of at least 20 percent overall, while continuing to generate funds to support MWR. A pro forma analysis (see chapter 3) indicates an increase in total earnings could be achieved if the exchange systems were consolidated. The accounting functions were specifically reviewed. Approximately $5.4 million could be realized from increased efficiencies gained by consolidating and centralizing the accounting functions.

■ ***Purchasing/Inventory Management.*** Efficiencies can be realized by consolidating the exchange services' buying and contracting functions. Consolidation of these functions into the existing AAFES infrastructure will eliminate the duplication

(Continued)

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that now exists. The AAFES system is capable of supporting the combined sales of the consolidated exchange system. It would require an incremental increase over current staffing levels of about 337 positions with wages, including fringe benefits, of about $9.8 million. Computed savings, within the purchasing area only, are projected to be 824 positions with salary of about $22 million.

■ ***Distribution/Transportation.*** Increased efficiencies would result from a consolidation of AAFES and NAVRESSO distribution centers in ConUS. The consolidated distribution system would have the capability of supporting the three current exchange systems. Consolidation of the Norton AFB (AAFES) replacement facility (with a project scope of $9.6 million, to be partially offset with base closure funds) and the NAVRESSOFSO San Diego distribution center at a cost effective location, or expansion of the San Diego facility, could not be accomplished before FY 93. Consolidation of exchange system management will also result in reduced overhead requirements at several overseas locations. Total annual savings from consolidation are estimated to be $9.7 million.

■ ***Management Information Systems.*** Consolidation of the three exchange systems into a single entity will require a worldwide communications and data processing capability. AAFES is the only exchange system with the existing MIS infrastructure that can support the many and varied businesses included in the exchange systems. Each part of the AAFES MIS infrastructure has been specifically designed to operate in every country with military presence. All MIS [components conform to the] applicable local laws, Status of Forces Agreements, U.S. military regulations and national/international communications protocols/equipment technical specifications. One-time costs of the MIS consolidation into the AAFES infrastructure is projected at $37.9 million, which would be offset by a MIS cost avoidance of $60.1 million, resulting in a net savings of $27.0 million [sic] over the projected costs of the three separate MIS support systems.

■ ***Operations Management.*** Even with differing retail store manning objectives and levels of management commitment, each exchange system is providing satisfactory customer service. To standardize store staffing levels under a total consolidation scenario, additional personnel costs of $13.3 million per year will be required. ***Other issues addressed include removal of current restrictions placed on mailing of promotional literature, and merchandise authorized for sale. Also, the sale of nonessential items in the commissaries must be addressed due to the impact of these sales on the exchanges' ability to generate funds for MWR.***

■ ***Food Operations.*** Total sales, profits and customer service would be enchanced by consolidation into a single system. Such an action would result in a one-time cost avoidance of $1.8 million for development of separate in-house food concepts. The proven AAFES food programs, modern information and management systems and worldwide organizational infrastructure dictate this system should be used as the core for a consolidated organization.

■ ***Services Operations.*** Services operations, such as barber and beauty shops, laundry and dry cleaning, tailor shops, automotive services, flower shops, electronic repair, tax preparation, optical, photo and film developing shops, etc., would generally continue to operate under consolidation as they do now. Although broad policies and procedures govern their operation, these activities are established and organized to meet local requirements and may be either direct (exchange operated) or concession (contractor operated) based on the situation. Annual savings of $0.3 million are possible through consolidation and reduction of headquarters staffs.

■ ***Design and construction.*** Centralized design and construction would be cost effective and increase efficiencies whether the exchange systems are consolidated or not. The AAFES organization has this capability. Projected savings are $2.9 million per year under total consolidation.

■ ***Personnel.*** A number of individual and collective improvements were identified in human resources programs. If consolidation occurs, they could result in new personnel programs which may be better able to attract, retain, compensate and reward employees.

■ ***Employee Benefits.*** Due to the number of variables present in the three systems and uncertainty over the design of successor plans for welfare benefits and retirement, a reasonable projection of costs/savings could not be estimated at this time. The only cost readily identifiable would be movement of Marine Corps and Navy Resale UA-13s and above would be movement of Marine Corps and Navy Resale UA-13s and above [sic] into the equivalent of the AAFES EMP supplemental deferred compensation benefit plan, the cost of which is estimated at $0.6 million annually.

During the course of this study, there were inferences by some Navy, Marine Corps and AAFES individuals that in the event of consolidation, AAFES initiatives would remain in place while initiatives of the other exchange systems would be lost. These perceptions are wrong. Each system has good ideas and, in the event of consolidation, the new organization would be expected to evaluate these ongoing initiatives and take the best from each system.

It should be noted that this is not the first study of the military exchange systems. A previous study, conducted for DoD by the Logistics Management Institute in July 1968, arrived at basically the same conclusions — consolidating the exchanges would eliminate redundancy and result in significant cost savings. That study recommended the exchanges be consolidated. The study noted that multiservice exchange operations worked well in Vietnam where AAFES provided support to all Services and they are working well on a much smaller scale in various other parts of the world today, such as in Okinawa, where AAFES exchanges support all services.

Given the complexity of the merger and the uncertaintities of the future, a phased approach should be adopted. Each exchange system is in the process of implementing critical phasedown actions to meet anticipated force reductions and base closures, and these independent efforts should continue as planned, but coordinated among the Services. Managing these changes, while at the same time attempting to consolidate into a single exchange system, would compound problems currently being addressed and increase the risk of adversely affecting customer service and earnings.

There are, however, potential savings from cooperative efforts that could be instituted immediately, as possibly the first step toward consolidation, which would result in savings and increased efficiencies within the overall exchange system. Additionally, such cooperative actions would begin to create the rapport, trust and working relationships needed to move to the total consolidation mode. Examples of such cooperative efforts, further discussed in the individual study chapters, include:

■ Facility design and construction.

■ Centralized distribution of specialized merchandise such as pre-recorded music and fine jewelry.

■ Consolidated development and procurement of in store electronic point of sale systems and other ADP equipment.

■ Transfer of operational support for exchanges based on the dominant system within a geographical area.

■ Consolidated European purchasing.

■ Quality assurance lab inspections.

■ Shared in-house fast food concepts.

■ Cross stocking of private label merchandise.

Due to the direct and close relationship between exchange and MWR programs, and the unique quality of life aspects of the exchanges, it is vital that the military Services continue to have direct control over the exchange system. This could best be accomplished through a joint board of directors, with a chairperson that rotates between the Army, Navy and Air Force, and full representation from each Service. Recommendations regarding the composition and responsibilities of such a board along with a proposed organizational chart are attached in Figure 1-3.

(Continued)

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The exchanges are "cooperatives." Ownership belongs to its [sic] customers, not a "government agency." The Board represents the customer base: soldiers, sailors, marines and airmen. The Board is a caretaker of the servicemember's monies, revenues earned by the military exchanges, and, as such, has a fiduciary responsibility for the servicemember's investment. It is the servicemember's money, not taxpayer money, to be distributed as dividends to the services.

The Board, as a responsible military governing body, must report through the respective Chiefs to the Services' Secretaries, not through a separate government agency. This is in keeping with the role of the military exchanges and the Command's role to maintain and provide for the Morale, Welfare and Recreation of the servicemember.

One of the major concerns of the Services during this study was the impact of consolidation on earnings and the availability of funding for MWR programs. The pro forma analysis in Chapter 3 indicates earnings would increase under consolidation, but a new dividend distribution policy would be necessary to ensure balance between support to MWR and exchange reinvestment and also consideration of existing assets of each Service. Any distribution method developed by the Board of Directors should consider ways to provide incentives for installation Commanders, to increase total exchange profits and avoid unnecessary competition with MWR.

The Navy Lodge Program, Navy Clothing and Textile Research Facility and Navy Ships Stores Afloat Program are unique entities to the NAVRESSO resale organization. These programs are vital elements of the Navy's quality of Life and shipboard MWR initiatives. They should be transferred internally within the Navy. Additionally, only traditional exchange functions from the combined Marine Corps exchange organization should become part of the consolidation.

The major savings from consolidation result from merging and reducing overhead staffs; centralizing procurement, accounting and construction functions; and eliminating duplicative warehouse and distribution activities. Very little change would be visible at the store operating level, with very little impact on customer service. In fact, by taking the best programs of each system, [patron support should improve. Service identity of the exchanges] could be retained through signing or other actions, similar to what is currently done with the Army "PX" and Air Force "BX" under AAFES. Furthermore, there is no reason to believe local exchanges would not continue to be responsive to, and support, the desires of local commanders.

RECOMMENDATION

The study group recommends that the military exchange systems be consolidated into a single organization in order to eliminate current redundancies, improve operational efficiencies and achieve projected annual savings from consolidation of $35 million plus a $9.6 million future reduction to Navy and Marine Corps Store staffing from implementation of the AAFES Store Automation Program (ASAP). The following elements should be included in the implementation plan for the consolidated exchange system:

■ A Joint Exchange Consolidation Task Force should be established to prepare and execute necessary implementing plans and documents; to review and coordinate major Service initiatives during the implementation period, ensuring they are in consonance with the consolidation effort; and monitor the completion of required actions.

The task force would be responsible for overall consolidation planning and execution. It should be made up of senior functional area representatives, detailed from each exchange system, and assisted as necessary by additional staffing on a temporary basis. The first objective of the task force would be to develop a comprehensive implementation plan addressing impact, interface and required actions in each functional area, thus providing the blueprint for the future. In addition to functional area interfaces, the plan shoud also include:

- Proposed structure for the new exchange system, staffing requirements and command and control relationships.
- Procedures for a review of Service initiatives to assure they complement the consolidation process.
- Milestones and time frames for accomplishing identified tasks.
- Checkpoints for review and evaluation of conslidation [sic] progress to confirm proper direction prior to moving from one phase to the next.
- Programs and open communications lines to educate and assist employees.
- Requirements for changes in regulations and other regulatory documents.
- Identification of a test site to validate implementation procedures.

■ Early implementation of cooperative efforts discussed herein, such as consolidated MIS procurement, centralized design and construction, centralized distribution of specialized merchandise, etc., should be to achieve initial savings and establish interface between the systems. Many of these offer substantial benefits, and could be implemented independent of any action on this study's recommendation. Besides the potential benefits from these programs, they would provide another mechanism for communications and cooperation between the existing exchange systems.

■ A review should be conducted at each implementation phase to ensure the correct course is being followed and projected benefits can be achieved.

■ A Board of Directors representing all Services, and responsible to the Service Secretaries, should be established to govern the consolidated exchange system and to manage and control what is, in effect, the servicemember's money and quality of life vehicle. This board would initially serve as an Exchange Consolidation Oversight Committee to guide the consolidation process. Since this board will become the governing body of the new consolidated exchange system, serving as the oversight committee will facilitate the transition to the consolidated organization and assumption of its responsibilities. Furthermore, interface with existing exchange boards will be facilitated since most consolidated board members are also directors of their respective exchange systems.

In addition to the major recommendation presented here, each functional chapter which follows has additional recommendations which, when implemented, will result in increased efficiencies, reduced costs and better customer service.

CLOSING

As stated earlier in this chapter, ***there are many uncertainties facing the exchange systems and any rash action regarding consolidation should be avoided. It is the opinion of this study group that, upon approval of the recommendation to consolidate the exchange systems, adequate time must be afforded for the development of a detailed plan prior to implementation. It would take two to three years beyond the actual implementation date before all implementating actions could be realized. A measured logical, methodical approach must be taken to minimize disruption to the existing work force and service to patrons.***

For the transition to a new Joint Service Exchange Instrumentality to be successful, the support and commitment of all affected parties is essential. This commitment, which must be clearly communicated throughout each exchange system, should emphasize the overall benefits of such a consolidation to both employees and customers. Without total support, the transition could be plagued by serious problems which might adversely affect customer service and earnings.

■ Please turn to charts, page 86

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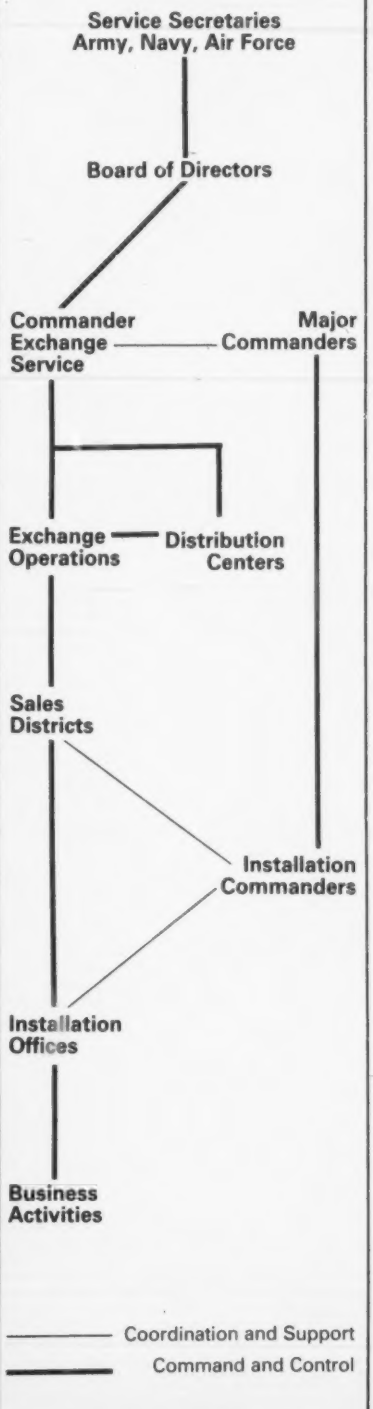
Recommended Organizational Structure Consolidated Exchange System



PERSONNEL IMPACT

	UA	HPP
Positions Affected	1,348	2,285
Relocate/Locally Place	379	589
Early Retirement	270	58
Reduction Action	699	1,638
New Organization HQ Requirement	380	300
Store Augmentation Requirement	*	*

**Not identified by number or category of personnel; estimated annual personnel cost, $13.3 million.*

UA — Universal Annual
HPP — Hourly Paid Person

ONE-TIME COST/BENEFIT (IMPLEMENTATION)

Items	Cost	Cost Avoidance
Personnel Relocation/ Severance Costs	$21.01M	
Training	$13.42M	
Other	.41M	$ 1.80M
Management Information System	$37.87M	$60.10M
TOTAL	$72.71M	$61.90M
NET COST	$10.81M	

COST/BENEFIT ANALYSIS*

Item	Savings (Cost Avoidance)	Additional Cost
Current costs of HQ, distribution, accounting & buying function to be deleted	$115.78M	
Augmentation of HQ, distribution, accounting & buying positions under consolidation		$77.75M
Other Economics	$ 9.26M	
Other Costs		$ 3.67M
TOTALS	$125.64M	$81.42M
New Initiatives Under Status Quo	$ 9.10M	
Net Annual Impact of Consolidation	$34.6 M	
Navy & MARCORPS Store Reductions Resulting from ASAP	$ 9.6 M	

**Cost/benefits stated in relationship to FY '89 operations.*

Market Report

Military Smokers are Turning to The Value-Priced Trend

By Michelle Zelsman, Associate Editor

Despite the U.S. trend toward a smokeless society, people in the tobacco industry know that there will always be smokers.

But many military smokers don't want to pay the money that full price cigarettes demand. Consequently, value priced cigarettes do proportionately better in the military than they do in the civilian market.

Brennan Dawson, vice president of public affairs for the Tobacco Institute, says that cigarettes account for over 95 percent of all tobacco sales. And, because "brands taste as different as Coke and Pepsi," only 10 percent of smokers switch to another brand each year.

New brands and brand extensions are the best avenues available for manufacturers to grow, says Dawson. But, even though generic or value priced smokes are successful, analyst John Maxwell of Wheat First Securities told MILITARY MARKET that they account for only 18 percent of the total market.

Irv Otte, director of military and vending sales for Brown & Williamson, says that in the military market, value priced smokes are holding up tobacco industry sales.

Although Otte says he wouldn't call the price situation a war, he does admit that tobacco companies are using value priced cigarettes to get smokers into their own camps.

Generally, smokers are brand loyal. But the military smoker is a little different, says Otte. "They are more interested in price," he says, adding that when costs go up on full priced cigarettes, "customers [switch] down and smoke more" of the cheaper smokes.

PRICE CAN BE A SMOKER'S BOTTOM LINE

One industry source, who asked not to be identified, says that sales of price value cigarettes continue to grow in the military because the smokers who are retired live on fixed incomes. While these retirees still want to smoke, they can't afford to pay the price hikes which come from federal excise taxes and industry price increases.

Dean Weller, tobacco buyer for the Army and Air Force Exchange Service, says that the price of cigarettes is "too far out of sight." He points out that, even though it is more economical to buy cigarettes by the carton, 50 percent to 65 percent of exchange cigarette sales come from single pack sales.

Top Savings Brands

"Savings brands" include generics, value 25s, and mid-priced (price/value) cigarettes.

NAME	SHARE OF MARKET FIRST HALF 1990	SHARE POINT CHANGE VERSUS YEAR-AGO
Liggett generic/pl	9.54%	-1.00%
*Doral	8.47%	+0.43%
Brown & Williamson generic/pl	4.11%	+0.10%
Cambridge	2.87%	+0.17%
Philip Morris generic/pl	2.30%	+0.04%
Richland (20)	2.05%	+0.50%
Pyramid	1.52%	+1.27%
Viceroy generic	1.01%	+0.31%
American	0.87%	+0.60%
Bristol	0.85%	+0.85%
Alpine generic	0.58%	+0.14%
Malibu	0.38%	-0.04%

*Doral is the #1 branded discount cigarette.

Source: Management Science Associates

Graphic Design for Military Market

"It's easier [on the pocket] to buy one [pack] at a time," says Weller.

Although tax increases play a role in the cost of tobacco, Weller says that the industry has probably been more at fault for jacking up the price "to keep the industry going." As unit sales decline, "dollar sales go up," because so do the costs, says Weller.

When a tobacco manufacturer offers a $3-off coupon for immediate redemption on a value priced carton of cigarettes, Weller says that the brand loyal smoker might make a one time purchase for the cheaper smokes. But usually the smoker will switch back to the old brand the next time they make a purchase.

For the most part, smokers stay with the brand they know and like. He points out that Philip Morris' Marlboro,

"Once consumers are taught to buy on price, not image, there's no going back."

Top 10 Military Brands

Brands are "families," including all flavor/size variations under a single name.

NAME	RANK 1990	1989	CHANGE
Marlboro	1	1	—
Brown & Williamson (generic/pl)	2	4	+2
Winston	3	2	-1
Salem	4	3	-1
Newport	5	6	+1
Liggett (generic/pl)	6	5	-1
Kool	7	7	—
Benson & Hedges	8	8	—
Doral	9	9	—
Camel	10	10	—

which is the No. 1 cigarette sold in exchanges, has consistently remained on top. "Smokers must like something about it [Marlboro], regardless of its price."

However, the growth of value priced cigarettes, which cost "half as much" as the full priced brands, according to Weller, may be an indication that there is a "shakeout of the cigarette industry."

It may prove to be more than an indication. *The Wall Street Journal* reported in September that RJR Nabisco will introduce its Sterling brand of budget cigarettes, which runs the risk of competing directly with RJR's own full-priced, more profitable brands.

However, Peggy Carter, an RJR spokeswoman, defines the Sterling brand as a premium cigarette that will have a permanent on-carton coupon. The target market is that niche of smokers who are "interested in the premium brands, but who have already decided they won't pay full price." RJR, she says, is committed to its full priced brands and "wouldn't do anything it thought would erode those brands." But, says Carter, Sterling "offers an alternative."

The *Journal* article went on to say that industry insiders are concerned, because "once consumers are taught to buy on price, not image, there's no going back."

THE ANTI-SMOKING TREND

Weller predicts that as smoking restrictions become more prevalent on military bases, the volume of tobacco sales will continue to fall at a rate of about 5 percent per year — which has been AAFES' experience.

Some elements in the military are actively discouraging smoking. For instance, the Strategic Air Command aims for a smoke-free service by the year 2000, notes Weller. He has already seen other evidence of this on some installations where smoking is not allowed in on-base buildings. In other places, smoking is not allowed in the local officers club or within 50 feet of it.

NAVRESSO's self-imposed ban on the sale of tobacco products in commissaries will remain "as long as it is under control of the Navy," says agency spokesman John Russas. Once the commissary agencies merge in October 1991 the new Defense Commissary Agency will have to decide whether cigarettes will be allowed to be sold in commissaries.

Russas says cigarettes are sold in only Navy exchanges because the wholesale prices at which they are sold in commissaries are "too attractive" and therefore promote smoking. Also, as with the other services, the exchanges' morale, welfare and recreation mission benefits from the profits that cigarettes bring. For example, said Russas, in 1989, of the $80 million NAVRESSO generated in cigarette sales, $20 million was given back to the service's MWR programs.

Tobacco manufacturers walk a very fine line in their marketing strategies. The Tobacco Institute's Dawson says that, because there are "always those [people who will be] offended by smoking," the industry markets only to those who are interested in purchasing its products.

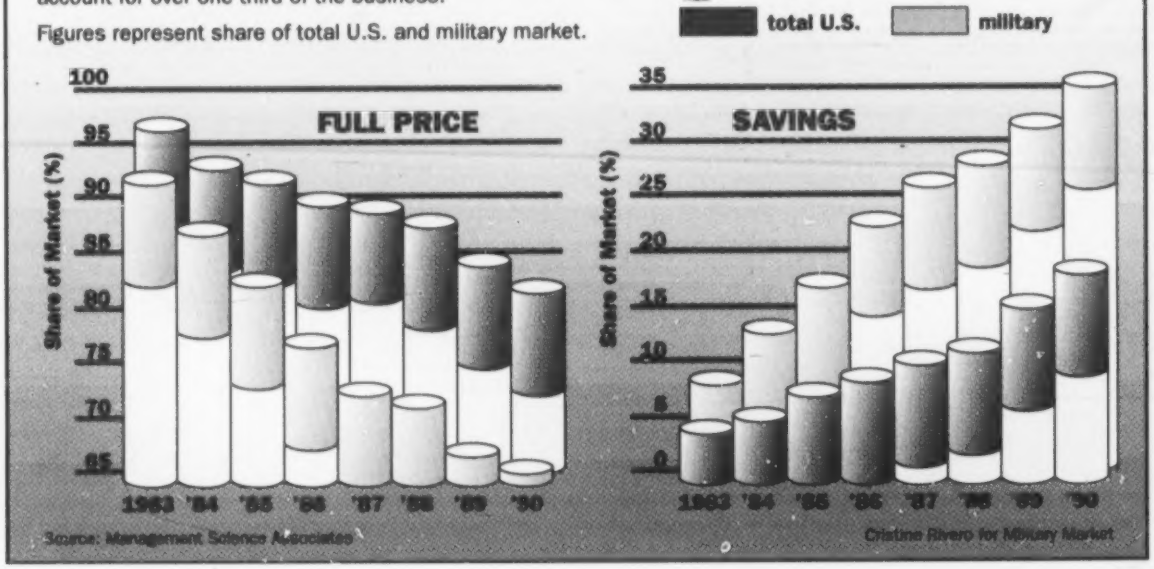
But with legislation pending in Congress that would further restrict tobacco advertising, the industry is watching closely as it plans its strategy. Dawson says that the issue is "very emotional" and that it hinges on constitutional rights.

(Continued, page 110)

Full Priced Brands Versus Savings Brands

All of the growth in the military cigarette market in recent years has been in the savings segment. Saving brands have has grown at a much faster rate than the total domestic market and now account for over one third of the business.

Figures represent share of total U.S. and military market.



(Continued from page 109)

Most industry people are doubtful that the legislation will ever become law. But if it did, tobacco advertising would be limited to a simple black and white format, similar to the all-type advertising of Wall Street securities. Wheat First's John Maxwell, a leading analyst of the tobacco industry, says that if the proposed restrictions are put into action, the current market for tobacco products would freeze in place, with no growth possibility for the future.

He also says that companies are moving away from "measured media" like magazines, newspapers and TV, and using more coupons, which is practically the only marketing activity that is allowed in the military.

Regardless of the problems associated with marketing tobacco, it's still considered an essential when American servicemembers deploy overseas. As troops continue to be deployed to Saudi Arabia, Weller says that "big quantities" of cigarettes are being shipped for sale in AAFES mobile exchanges.

Other tobacco items AAFES is sending are cigars, chewing tobacco and large quantities of snuff.

While smoking restrictions vary by installation, the volume of snuff that is sold is growing in terms of both units and dollars. AAFES' Dean Weller says that AAFES sells ten times more snuff than it does chewing tobacco.

Sales of the finely ground tobacco product are growing because snuff fulfills a user's nicotine need without violating local smoking restrictions. And, unlike chewing tobacco, snuff doesn't create a juice, so there is no spitting involved. On top of all that, snuff also appeals to women because it can be used discreetly. MM